

Analyst: Paul Sham
CITIC INTERNATIONAL FINANCIAL HOLDINGS LIMITED (中信國際金融)

Sector	: Banking	Chairman	: Mr. Kong Dan
HKSE Code	: 0183	CEO	: Mr. Dou Jianzhong
Market Price	: HK\$5.72 (21/08/2008)		
Shares Issued	: 5,757.6m		
Mkt. Cap.	: HK\$32,933.5m		
52 weeks Hi/ Lo	: HK\$6.97 / HK\$3.19		
HSI	: 20,392.06 (21/08/2008)		
Main Business	: Banking and related financial services		

SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30TH JUNE 2008
Interim Results Highlights

	HK\$ million	Vs 1H2007 (%)	Vs 31/12/2007 (%)
• Net interest income	790.0	+25.2%	
• Non-interest income	(154.1)	-122.6%	
○ Net loss and write-down on SIVs	(717.9)	NA	
• Total operating income	635.9	-51.5%	
• Operating expenses	(689.9)	+12.3%	
• Operating profit before impairment losses	(54.0)	-107.7%	
• Impairment losses on loans and advances	9.5	-122.4%	
• Share of profits of associates	1,442.9	+95.8%	
• Profit before taxation	1,462.6	-9.6%	
• Taxation	(22.4)	-79.2%	
• Attributable profit to shareholders	1,440.2	-4.6%	
• Total loans	75,424.5	+25.0%	+14.6%
• Total deposits	83,606.3	+1.5%	-7.8%
• Total assets	134,081.4	+8.1%	+1.3%
• Basic EPS (HK\$)	0.2501	-8.7%	
• Interim DPS (HK\$)	0.0	Unchanged	
Selected Ratios	1H2008	1H2007	FY2007
• Net interest margin (^)	1.76%	1.86%	1.86%
• Cost-income ratio	108.5%	46.8%	96.8%
• Return on average assets	2.62%	2.52%	1.60%
• Return on average equity	12.61%	11.95%	7.40%
• Impaired loan ratio	1.24%	1.45%	1.15%
• Impaired advances coverage	32.5%	39.3%	38.9%
• Loan-deposit ratio	90.2%	73.3%	72.6%
• Capital adequacy ratio (^)	15.6%	15.3%	15.8%
• Average liquidity ratio (^)	34.4%	40.8%	40.8%

Remark: (^) for CITIC Ka Wah Bank

- **1H08 net profit saved by CNBC** CITIC International Financial Holdings (CIFH)'s 1H08 net profit declined by 4.6% y-o-y to HK\$1,440m, helped by the substantial contribution of HK\$1,388m from the group's 15% stake in China CITIC bank (CNCB). Excluding the contributions from CNCB, pre-tax profit was just HK\$74m. The sharp decline in underlying operating earnings in 1H08 was primarily due to the HK\$717.9m write-down of the group's remaining SIV investments.
- **Growth in net interest income but margin contracted** CIFH recorded a 25.2% y-o-y rise in net interest income but the net interest margin (NIM) contracted during the period. The NIM was affected by the sharp increase in liquidity cost as a result of intense competition from industry peers to build

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customer deposits and the pressures exerted on deposit margins. As a result, the NIM fell 10 basis points compared to a year ago to 1.76%.

- **Outstanding loan growth** CIFH's loan growth in the first half (+25.0% y-o-y, 14.6% h-o-h) was significantly ahead of the overall performance of the HK bank sector. The primary driver of the increase in loans was the very strong growth in the group's offshore lending operations (+44.3% y-o-y), attributable to the greater co-operation between CIFH's wholly owned commercial banking subsidiary CITIC Ka Wah Bank (CKWB) and CNCB with respect to cross border referrals and CIFH's decision to expand its lending activities to other parts of Asia. With contracting deposit size on tightening of market liquidity and the low interest rate environment, loan-to-deposit increased to 90.2% from 72.6% in December 2007.
- **Healthy non-interest income momentum** CIFH's net fee and commission income alone grew by a healthy 13.4% y-o-y in 1H08, driven by a 31.3% increase in corporate loans related income, a 17.9% increase in wealth management related income, and a 32.8% increase in trade bills commissions. Nevertheless, impacted by the marked-to-market write-downs from the SIVs, CKWB's non-interest income recorded a loss of HK\$154m, compared to HK\$672m net income in 1H07.
- **Zero SIVs but risky investment remains** During FY07, CIFH wrote down HK\$1,311.2m of its SIV investments while in 1H08, CIFH made a further write-down of HK\$717.9 million. As at 30th Jun 2008, the Group did not have any exposure on SIVs. But CIFH still has two remaining structured investments – HK\$667m in a 'Portable Alpha' fund which is expected to be redeemed in September 2009, and US\$84.4mn (HK\$658m) worth of capital notes issued by Farmington Finance, which is considered as a cash flow CDO.
- **Cost-to-income ratio distorted by write-downs** Operating expense rose 12.3% y-o-y, primarily driven by higher staff costs (+7.7% y-o-y) and property and equipment expenses (+16.2% y-o-y). But CIFH's cost-to-income ratio jumped from 46.0% in 1H07 to 92.0% in 1H08 due primarily to the marked-to-market write-downs from the SIVs.
- **Strong contribution from CNCB offset the top-line disappointment** Aggregate profit contribution from the Group's associate companies climbed substantially by 95.8% y-o-y, primarily derived from a 1.5 times increase in profit contribution from CNCB to HK\$1,388m. The Group's non-bank financial businesses, its 50%-owned CITIC Capital Holdings Limited and its 40%-owned CITIC International Assets Management Limited, contributed to an aggregate of HK\$55m.
- **Increasing loan loss provisions** There was a 24% h-o-h, or HK\$180.5m rise in NPLs to 1.24% impaired loan ratio from 1.15% as at end-2007. CIFH revealed a bigger negative in a footnote referencing a HK\$203m single-customer loan (0.27% of total) that went overdue after end-June, representing a 22% of end-June NPL levels.
- **Profitability maintained, with healthy financial position** Driven by the hefty contribution from CNCB, ROE and ROA rose to 12.61% and 2.62% respectively in 1H08 from 11.95% and 2.52% in 1H07. Meanwhile, CKWB's CAR stood at 15.6% as of 30/06/2008.

Outlook & Prospects

- **Deteriorating loan quality** It was recently reported that Tack Fat Group (00928.HK) had defaulted on HK\$278m in loans, of which HK\$133m was owed to CKWB. It may be one of the early signs showing CKWB's increased uncertainty on asset quality going forward, premised on the bank's fast growing China loan book, lower collateral levels, and the newly disclosed HK\$203m post balance sheet overdue loan.

- **Privatisation update** CITIC Group is offering one CNCB share plus HK\$1.46 in cash to minority shareholders in CIFH. This offer is viewed as unattractive by the public as it was estimated that the proposal represents only a PB multiple for the Hong Kong unit of just 1.0x, compared with the sector PB multiples of 1.5-1.6x. Investors are expecting higher offer in the range of HK\$7.0-HK\$9.0 before the announcement, especially when CMB paid 2.91x for Wing Lung Bank recently.
- **Fully valued** Given that the stock is in the process of being privatized, near-term stock performance will be linked to privatization activity. Investors are expecting the possibility of CITIC Group's revising up the offer price before the voting by shareholders. However, we view the current proposal offered by CITIC group reasonable as we should apply a holding company discount to companies with complicated shareholding structure like CIFH's. Therefore, WLB deal of 2.91x PB multiply may not be an appropriate benchmark for CIFH's privatisation case and we believe the current stock price is fully valued.

Recommendation: *Fully valued*

I. Impairment allowances, overdue and rescheduled advances of CIFH

As % of total customer advances	Individual allowance	Portfolio allowance	Non-performing loans	Overdue and rescheduled advances
As of 30/06/2008	0.17%	0.24%	1.24%	1.18%
As of 31/12/2007	0.11%	0.34%	1.15%	1.14%
As of 30/06/2007	0.14%	0.43%	1.45%	1.70%

II. Comparison of CIFH's loan book: 30/06/2008 vs 31/12/2007

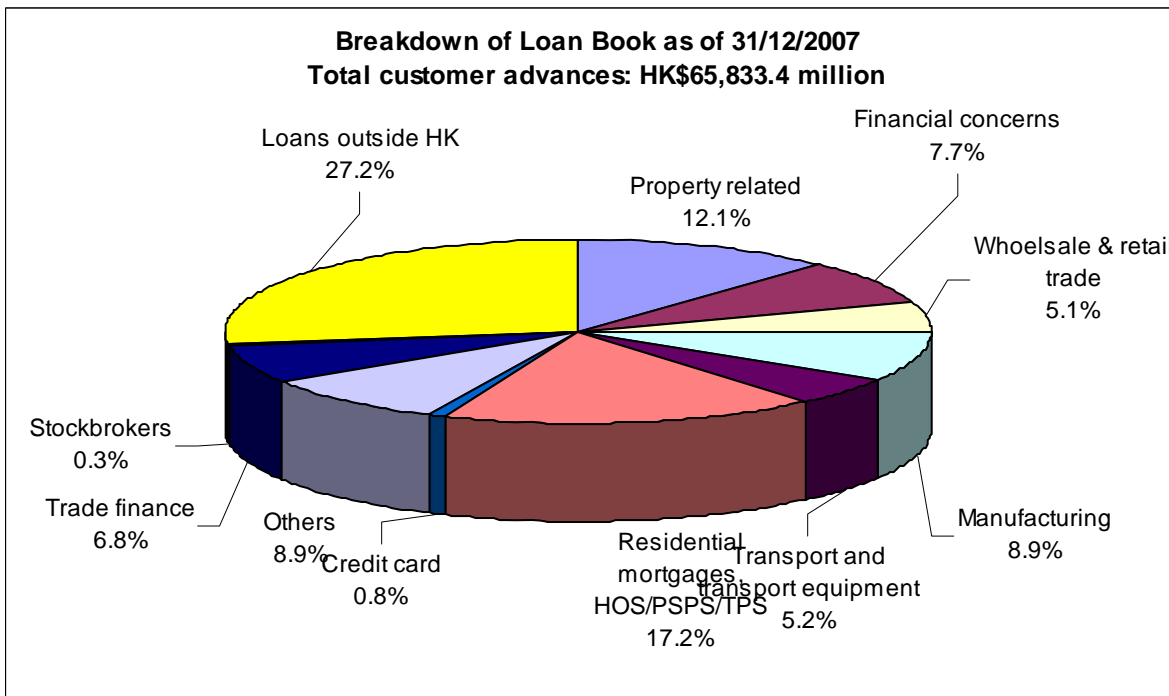
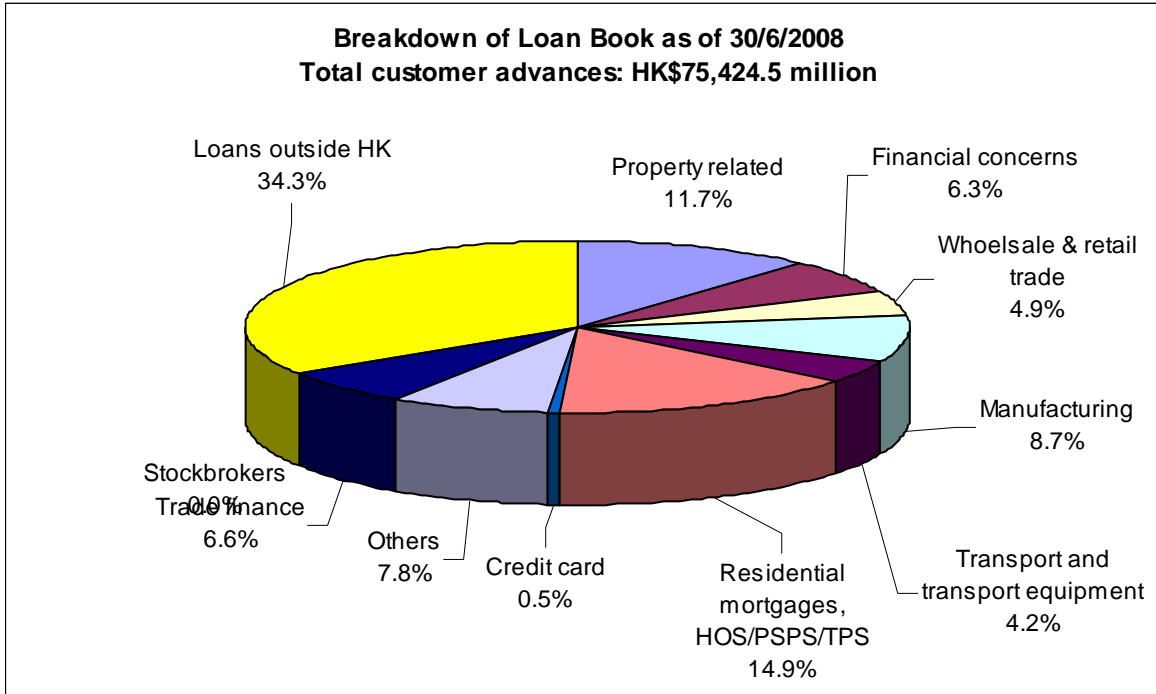
Loans-by industry	30 th Jun, 2008 HK\$ million	Up/(down)	31 st Dec, 2007 HK\$ million
Property related	8,816.2	+10.9%	7,947.7
Financial concerns	4,747.4	-6.2%	5,061.0
Wholesale & retail trade	3,697.9	+9.3%	3,383.9
Manufacturing	6,599.3	+13.1%	5,834.0
Transport & transport equipment	3,160.1	-6.9%	3,394.2
Residential mortgages, HOS/PSPS	11,252.8	-0.6%	11,319.5
Credit card	384.7	-24.1%	506.8
Others	5,916.4	+1.4%	5,835.4
Trade finance	4,991.5	+11.7%	4,467.5
Stockbrokers	19.5	-89.2%	181.0
Loans outside HK	25,838.8	+44.3%	17,902.5
	<u>75,424.5</u>	<u>+14.6%</u>	<u>65,833.4</u>

III. Comparison of CIFH's loan book: 30/06/2008 vs 30/06/2007

Loans-by industry	30 th Jun, 2008 HK\$ million	Up/(down)	30 th June, 2007 HK\$ million
Property related	8,816.2	+42.4%	6,189.4
Financial concerns	4,747.4	+71.7%	2,765.4
Wholesale & retail trade	3,697.9	+19.5%	3,093.6
Manufacturing	6,599.3	+51.8%	4,347.1
Transport & transport equipment	3,160.1	+1.0%	3,127.8
Residential mortgages, HOS/PSPS	11,252.8	-0.7%	11,334.9
Credit card	384.7	-14.3%	448.8
Others	5,916.4	+26.7%	4,668.7
Trade finance	4,991.5	+16.5%	4,285.8
Stockbrokers	19.5	-99.6%	4,885.7
Loans outside HK	25,838.8	+70.3%	15,173.6
	<u>75,424.5</u>	<u>+25.0%</u>	<u>60,320.8</u>



Breakdown of loan book of CIFH



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